SUMMARY OF ARGUMENT

Staff notes that this attachment is a summary of Staff's arguments, rather than a part thereof, and to the extent that any statement or representation in this Attachment A conflicts with any assertion that Staff advanced either in its testimony or briefs, the latter govern. Staff specifically reserves all the arguments made in its testimony and briefs, and the failure to specifically include some such argument or part thereof in this attachment should not be deemed a waiver of such argument. Finally, Staff notes that it was not possible, due to exigencies of the process of document preparation, to include in this attachment references to Staff's Reply Brief, filed contemporaneously. Accordingly, Staff will submit an erratum to this attachment that contains such references.

I. Introduction/Summary of Position

Staff is convinced that SBC's retail business NAL is subject to imputation; that the UNE loop is a noncompetitive service or service element used to provide a competitive service within the meaning of Section 13-505.1 of the Public Utilities Act, such that SBC's retail business NAL must satisfy imputation based upon the TELRIC rate it charges for the UNE loop. Staff is further convinced that a "narrow" imputation test is the only lawful and proper test to use, and that revenues from usage and vertical services cannot and should not be included. Staff contends that SBC's retail business NAL rates do not pass imputation under a properly constructed test. Staff notes that there a number of rate design options that SBC can use to deal with this problem, but the Commission is under no obligation to give SBC direction or guidance in this regard. Finally, the Staff argues that Section 276 does not preempt the application of the imputation test to COPTS rates, and those rates can be altered consistent with both Section 276 and imputation, based on the methodology established by the Commission in its *Payphone Order*.

II. How to Define the "Service" Subject to Imputation in this Proceeding

A. Direct Testimony

This is primarily a legal issue, not specifically addressed in Staff testimony.

B. Rebuttal Testimony

This is primarily a legal issue, not specifically addressed in Staff testimony.

C. Legal Argument in Briefs

Staff notes that, in this proceeding, the Commission must decide, among other things, how in what form SBC Illinois' retail business network access lines ("NALs") are subject to imputation as a competitive telecommunications "service" under Section 13-505.1 of the PUA. Staff IB at 10. It is Staff's position that SBC Illinois' NALs are subject to imputation as a stand-alone, individualized service *without regard to any revenues garnered from other competitive services* that SBC Illinois (or a competitive carrier) obtains in conjunction with that service. Staff IB at 10, *citing* Staff Ex. 1.0 (Koch Direct), at 15-19, 22-27; Staff Ex. 2.0 (Koch Rebuttal), at 2, 4-8. In practical terms, Staff believes the only acceptable description of SBC Illinois' NALs as a competitive "service" for imputation purposes is that of a business customer that (1) has no local or toll usage, (2) has no subscription to any central office features, such as vertical services, and (3) does not generate any switched access revenue for SBC Illinois. Staff IB at 10. Staff notes that its witness, Robert F. Koch, demonstrates in his testimony that *any* inclusion of local or toll usage, central office features or switched access revenues in the imputation test of SBC Illinois' NALs would render the test impotent. Staff IB at 11, citing Staff Ex. 1.0, at 16-17; Staff Ex. 2.0, at 5-8. Staff's position is also shared by Joint CLECs. Joint CLEC Ex. 1.0 (Webber Direct), at 6, 13-20; Joint CLEC Ex. 20.0 (Webber Rebuttal), at 3-18.

Staff notes that SBC Illinois and CUB both urge the Commission to broaden Staff's description to also include local and toll usage, central office features and/or switched access revenues. Staff IB at 11. SBC Illinois and CUB reason that these revenues should be included because CLECs obtain revenues from these other competitive services when offering NALs to business end users. SBC Ex. 1.0, at 9,17-22; SBC Ex. 1.1, at 7-15, 18-27; CUB Ex. 1.0, at 2-14; CUB Ex. 2.0R, at 3-4, 9-13. The SBC/CUB proposal is without merit and is tantamount to reading the imputation test out of the statute. Staff IB at 11.

As Staff demonstrates in its Initial Brief, Section 13-505.1's plain language and legislative history, and past Commission practice demonstrate that SBC Illinois' NALs are subject to imputation on a stand alone basis without regard to revenues from other competitive services used in conjunction with the company's NALs. Staff IB at 12. Staff's treatment of the issue demonstrates that Staff's position (and that of Joint CLECs) represents the proper application of the imputation test to SBC Illinois' NALs. SBC Illinois and CUB's proposal, on the other hand, should be disregarded. Staff IB at 12.

Staff first demonstrates that the plain language of Section 13-505.1 requires that the imputation test be passed on a stand-alone basis. Staff IB at 12 et seq. Section 13-505.1 directs the Commission to define SBC Illinois' NALs for imputation purposes on a stand-alone basis to prevent the company from engaging in price squeeze of competing carriers. Id. Any analysis must begin with the statute itself because it is the best source of legislative intent. Staff IB at 12 (citations omitted).

Staff notes that, in 1992, the General Assembly enacted Public Act 87-0856, which included the imputation requirement as part of the legislature's overall rewrite of Article XIII of the PUA. Staff IB at 12 (citations omitted). Section 13-505.1 states in full:

Sec. 13-505.1. Imputation.

(a) This Section applies only to a telecommunications carrier that provides both competitive and noncompetitive services. If a carrier provides noncompetitive services or noncompetitive service elements to other telecommunications carriers for the provision by the other carriers of competitive services, switched interexchange services, or interexchange private line services or to other persons with which the telecommunications carrier also competes for the provision by those other persons of information or enhanced telecommunications services, as defined by the Federal Communications Commission, then the telecommunications carrier shall satisfy an imputation test for *each of its own competitive services*, switched interexchange services, or interexchange private line services, that utilize the same or functionally equivalent noncompetitive services or noncompetitive service elements. *The purpose of the imputation test is to determine whether the aggregate revenue for each service exceeds the costs, as defined in this Section, to be imputed for each service based on the telecommunications carrier's own routing arrangements*. The portion of a service consisting of residence untimed calls shall be excluded from the imputation test. The imputed costs of a service for purposes of this test shall be defined as the sum of:

(1) specifically tariffed premium rates for the noncompetitive services or noncompetitive service elements, or their functional equivalent, that are utilized to provide the service;

(2) the long-run service incremental costs of facilities and functionalities that are utilized but not specifically tariffed; and

(3) any other identifiable, long-run service incremental costs associated with the provision of the service.

(b) Notwithstanding the provisions of subsection (a), if a telecommunications carrier permits other telecommunications carriers to purchase interexchange private line services, except those provided under contract or other form of agreement pursuant to the provisions of Section 13-509, under the same tariffed rates, terms, and conditions as any other customer, then such interexchange private line services provided by the telecommunications carrier shall not be subject to the imputation test required in this Section.

220 ILCS 5/13-505.1 (emphasis added).

To paraphrase, Section 13-505.1 applies to incumbent local exchange carriers, like SBC Illinois, that serve more than 35,000 subscriber access lines. Staff IB at 13. Staff argues that, under the statutory provision, "*each*" of SBC Illinois' "competitive services" are subject to imputation where the company provides competing carriers with "noncompetitive services or noncompetitive service elements" that competing carriers need to use as inputs to provide the same competitive service as SBC Illinois. Id., citing 220 ILCS 5/13-505.1(a).

Staff noted that the purpose of the test is to ensure that against a price squeeze in the competitive marketplace. Staff IB at 13. To that end, the imputation test requires that SBC Illinois' revenue (or retail rate) for providing a competitive service equals or exceeds the costs competing carriers *must* face in order to compete against SBC Illinois in the market for that service. Id. Imputation only applies SBC Illinois' competitive services that utilize "noncompetitive services" or "noncompetitive service elements" in provisioning of the same individual competitive service. Id. at 14. For present purposes, and discussed in more detail elsewhere in Staff's Initial Brief, the "noncompetitive services or noncompetitive service elements" are the necessary inputs or bottleneck facilities or equipment that competing carriers must obtain from incumbent carriers, such as SBC Illinois, to provide the same competitive telecommunications service. These bottleneck facilities may include unbundled network elements (or UNEs). Staff IB at 14.

Staff notes that Section 13-505.1 also states that the formula for calculating the costs of service for imputation purposes consists of three components: (1) SBC Illinois' tariffed rates for the noncompetitive services or noncompetitive services elements that are used to provide the resulting competitive service; (2) SBC Illinois' long-run service incremental costs (LRSIC) for facilities and functionalities that are utilized by the competitive service but not specifically tariffed by SBC Illinois; and (3) any other SBC Illinois LRSIC costs associated with the provision of the competitive service. Staff IB at 14.

In short, Staff argues that the plain language of Section 13-505.1 directs the Commission to undertake two analyses. Staff IB at 14. First, SBC Illinois must pass imputation "for *each* of its own competitive services[.]" Id. (emphasis added). Second, the imputation test ensures that SBC Illinois' aggregate revenue (or retail rate) "for each [competitive] service" at issue meets or exceeds the cost of service faced by competing carriers to provide the same competitive service as SBC Illinois. Id. Based on these instructions, Staff argues that the Commission must analyze SBC Illinois' competitive services on an individualized, stand-alone basis without factoring in (or commingling) revenues of *other* competitive services that *may be* associated with the competitive service that is subject to imputation. Id.

Moreover, Staff contends that the plain language of the provision makes no mention of the revenues competitive carriers *might obtain* by offering the same competitive service as SBC Illinois—let alone revenues CLECs obtain from *other* competitive services associated with that service. Staff IB at 15. In Staff's view, the statute simply requires the Commission to compare *SBC Illinois'* retail rate for the competitive service at issue against the company's imputed costs for that service, and determine whether that retail rate is equal to or greater than the imputed costs. Id. Staff observes that there is no mention whatever of the section applying in any way to a non-ILEC, or of the consideration of any non-ILEC revenues. Id. Accordingly, Section 13-505.1's silence with regard to CLECs dictates that these carriers' *potential* revenues are irrelevant and it would be improper for the Commission to consider them in formulating any imputation test for a specific service. Id., *citing* Illinois Bell Telephone Co. v. Ill. Commerce Comm'n, 203 Ill. App. 3d 424, 438 (2nd Dist. 1990) (stating two germane principles: (1) "the fact that no statute precludes an agency from taking a particular action does not mean that the authority to do so has been given by the legislature"; and (2) "[a]s a matter of statutory construction, the expression of one thing in an enactment excludes any other, even if there are no negative words prohibiting it.").

Staff notes that the same result inures when Section 13-505.1 is read in concert with Section 13-502.5 of the PUA. Staff IB at 15-16. In Section 13-502.5(b), the General Assembly declares that all retail telecommunications services provided to business end users as competitive services, which includes usage and vertical services for those end users. Id.; 220 ILCS 5/13-502.5(b). Further, Section 13-502.5(c) specifically identifies retail vertical services as competitive services. 220 ILCS 5/13-502.5(c). In short, Section 13-502.5(b) and (c) treat usage and vertical services as *separate* competitive services.

In sum, within the context of an imputation test of SBC Illinois' NALs, it is Staff's opinion that the Commission *cannot* include the potential complimentary revenues that may be derived from a business customer's usage or use of vertical services, as SBC Illinois and CUB insist. Staff IB at 16. The plain language of Section 13-505.1 itself and when read in conjunction with Section 13-502.5 make clear that the Commission must define SBC Illinois' NALs, for imputation purposes, as applying to all business customers without regard to their proclivity for complimentary competitive services. As such, the competitive service subject to imputation in this proceeding must be that of a business customer that (1) has no local or toll usage, (2) has no subscription to any central office features, such as vertical services, and (3) does not generate any switched access revenue for SBC Illinois. Id. Any other configuration would, in Staff's view, render the test a pointless nullity. Id.

If Section 13-505.1's plain language were not enough, Staff advances substantial arguments that the legislative history also supports Staff's view that the Commission must define a "service" subject to imputation on a stand-alone basis. Staff IB at 17, et

seq. Staff notes that, aside from enacting the imputation requirement, Public Act 87-0856 also amended Section 13-507. Staff IB at 17. Generally speaking, Section 13-507 requires that the aggregate revenue for *all* of SBC Illinois' competitive services must be equal to or greater than the aggregate costs for *all* its competitive services. 220 ILCS 5/13-507. Id. Staff states that the reason for this test is to protect against subsidization of competitive services by noncompetitive services. Id. The logic is that, if it can be shown that the revenue for the company's competitive services as a whole exceeds their costs as a whole, then it cannot be found that these services are being subsidized. Id.

Staff observes that Public Act 87-856 was the product of Conference Committee Report #1 to Senate Bill 511 of the 87th Illinois General Assembly. Staff IB at 17. The House sponsor of the bill was Representative James McPike, while its Senate sponsor was Senator Denny Jacobs. Id. On floor debate, the following statement was read into the record in both the House of Representatives and Senate solely for purposes of legislative intent, as illustrated in the House debates below:

Rep.McCracken: Mr. McPike, I would like to confirm whether I'm correct in certain legislative intent of the Bill. I'd like to read the statement and ask if this is a correct statement of legislative intent. "The legislative intent of the Amendments to Section 13-507 is to establish that common facilities and expenses shall be allocated to noncompetitive services as a group and to competitive services as a group, and shall not be allocated to individual services. *Aggregate revenues for competitive services as a group must be equal to or greater than the aggregate costs, including the combination of imputed tariffed rates on a protective basis for all* ***individual*** *services where required by new Sec. 13-505.1, all other* ***individual*** *services incremental costs, and all common facilities and expenses allocated to competitive services as a group. However, that portion of competitive services which is accounted for by imputation of noncompetitive tariffed rates shall be excluded from the basis for deriving the allocation of common facilities and expenses to competitive services as a group.*" Is that correct, Sir?

Rep. McPike:Yes, Mr. McCracken. That is correct.

Id. at 17-18, citing 87th Ill. Gen. Assem., House Proceedings, May 13, 1992, at 64-65 (colloquy of Representatives James McPike and Thomas McCracken) (emphasis added); 87th Ill. Gen. Assem., Senate Proceedings, May 13, 1992, at 23-24 (colloquy of Senators Denny Jacobs Richard Luft) (same).

The above passage is significant in Staff's view because it describes the process of formulating the aggregate revenue test for Section 13-507, which has subsequently been codified in Code Part 792.200. 83 Ill. Admin. Code § 792.200. Staff IB at 18. Although the particular discussion is in regard to the legislature's amendment to Section

13-507, there are two significant insights that can be garnered from the passage that are germane to the legislature's intent of Section 13-505.1. Id.

First, Staff notes that the aggregate revenue test under Section 13-507 is a single test that is performed on the entire set of incumbent carrier's competitive services at the same time. Staff IB at 19. It is a separate and distinct test from the one conducted for imputation, and its intent is different. Id. In contrast, the aggregate revenue test required for imputation under Section 13-505.1 is limited solely to an incumbent carrier's revenues from one stand-alone competitive service. Id. As such, the "aggregate revenue" test of Section 13-507 and Code Part 792, which implements Section 13-507, should be applied differently than the test applied under Section 13-505.1 for imputation purposes. Id. Section 13-507's test is an amalgamation of revenues for all of SBC Illinois' competitive services, while Section 13-505.1's test is limited to SBC Illinois' revenues for a single competitive service. Id.

Staff notes that this is significant because SBC Illinois witness Panfil and CUB witness Dunkel have attempted to supplant imputation's "aggregate revenue" test with Section 13-507's aggregate revenue test by introducing revenues from other competitive services into the imputation test of SBC Illinois NALs. Staff IB at 19, citing SBC Ex. 1.0, at 9,17-22; SBC Ex. 1.1, at 7-15, 18-27; CUB Ex. 1.0, at 2-14; CUB Ex. 2.0R, at 3-4, 9-13. Staff notes that Mr. Koch made this distinction clear on cross-examination in response to questions posed by the Administrative Law Judge. Staff IB at 19, citing Tr. 62-69.

Second, Staff notes that Representative McCracken specifically references imputed costs as relating to individual services. As such, the above statement indicates that the sponsors of Public Act 87-0856 intended to subject competitive services to imputation on an "individual service" basis rather than lumping those services together for purposes of imputation. Staff IB at 19, citing Spinelli v. Immanuel Evangelical Lutheran Congregation, Inc., 144 Ill. App. 3d 325, 330 (2nd Dist. 1986) quoting in part 2A A. Sutherland, STATUTORY CONSTRUCTION § 48.15, at 337 (1984) ("statements by the sponsor of the legislation are especially significant [in discerning legislative intent] 'since legislators look to the sponsor* * * to be particularly well informed about its purpose, meaning, and intended effect.'").

Staff next shows that the Commission, in its past imputation decisions, has concluded that, while it has the authority to define the competitive "service" subject to imputation, any Commission-approved "service" definition must serve the statute's fundamental goal—barring incumbent carriers from engaging in anticompetitive pricing behavior that prevents competitive carriers from providing competitive services at competitive rates. Staff IB at 20. In Staff's opinion, those past decisions demonstrate that the Commission has traditionally defined those competitive services subject to imputation on a disaggregated, case-by-case basis because a "narrow" definition of the

"service" subject to imputation serves as the best means to accomplish the statute's fundamental goal. Id. In turn, Staff argues, the Commission has repeatedly rejected the use of a broad definition of "service" for imputation purposes because to do so would negate the very purpose of the test. Id. In addition, Staff asserts that the Commission's imputation test has evolved over time to the point where the Commission requires an incumbent carrier's network access lines, such as SBC Illinois' NALs, to pass imputation. Id.

Staff notes that, shortly after Section 13-505.1's enactment, the Commission initiated a rulemaking proceeding to implement the provision. In its initiating order, the Commission stated that the then-new statute requires incumbent carriers to satisfy an imputation test on a stand-alone basis for *each* of its competitive services. Staff IB at 21. Two years later, in 1994, the Commission determined in its *MCI Complaint Order* that Section 13-505.1 provides the Commission with the authority to define the competitive services subject to imputation. Id. In so doing, the Commission adopted Staff's view that in defining those services the Commission "must examine offerings on a case-by-case basis utilizing all relevant criteria, with its main goal being to prevent and discourage anticompetitive pricing and behavior." Id.

Similarly, in the Commission's *First Alt-Reg Order*, both Staff and Ameritech took the position that the Commission can only determine what services are subject to the imputation "on a case-by-case basis." Staff also argued that "attempting to define what constitutes a [competitive] service *by examining functionalities, or service titles alone* [of SBC Illinois' tariff] may not achieve the fundamental goal of imputation." Staff IB at 21. Staff explained that while these tariff "titles" may "provide meaningful guidance":

> [T]he determination of the level of disaggregation for imputation (i.e., what services or elements of services should be subject to imputation) should be mainly driven by the goal of guarding against anti-competitive behavior. In other words, [the Commission must evaluate] whether a competing carrier possibly was being prevented from providing services at competitive rates due to the rates it is charged by [SBC Illinois] for essential, noncompetitive inputs to the competing carrier's service.
>
> Staff IB at 22.

In that order, Staff notes that the Commission again adopted Staff's position when it explained that imputation "tests are intended to determine whether the rates that a[n] [incumbent] carrier charges a competing carrier for certain noncompetitive service elements are discriminatory. [These tests] are used to analyze whether competitors of a carrier, who are also customers of that carrier, are being prevented from providing services at competitive rates." Id.

Staff further notes that in 1995, in the Commission's *Customers First Order*, AT&T and MCI argued, among other things, that Ameritech's unbundled loops and ports that make up its network access lines ("NALs") should be subject to separate imputation tests. Staff IB at 22. Staff disagreed, but claimed that Ameritech's unbundled loops and ports may be subject to imputation depending on Ameritech's rate design. Id.

Ameritech responded that the Commission had no authority to subject its NALs to imputation. Staff IB at 22. Ameritech reasoned that since Section 13-505.1 only explicitly required tests "for switched interexchange services and competitive services" the Commission could not subject its NALs to imputation because NALs were not explicitly listed in the statute. Id. at 23.

The Commission rejected Ameritech's claim, holding that it had the discretion to subject Ameritech's NALs to imputation even though the statute and the Commission's imputation rules did not specifically mention NALs. Staff IB at 23. At the same time, the Commission declined to adopt AT&T and MCI's proposals to subject Ameritech's unbundled loops and ports to separate imputation tests. Id. Instead, the Commission accepted Staff's position that Ameritech's NALs were subject to an imputation-type test whereby the total cost for the unbundled portions of Ameritech's NAL "i.e., the loop, port, [and] monthly connection charges" could not exceed "the total price of the bundled line providing the same services and functionalities." Id.

Staff further notes that, in 1996, in the Commission's *AT&T Wholesale Service Order*, AT&T asked the Commission, among other things, to determine whether Ameritech's wholesale services must pass imputation. Staff IB at 23. Ameritech argued in response that the imputation test only applies to retail service rates, not wholesale service rates. Id. Staff supported AT&T's position and asserted that "Section 13-505.1 requires imputation [of Ameritech's wholesale service rates], and even if it did not, the Commission should require imputation." Id. The Commission concluded that Ameritech's wholesale services were indeed subject to imputation because the intent of the imputation requirement "is to ensure that incumbent LECs (*e.g.,* Ameritech and Centel) are not able to use the prices of their noncompetitive inputs to squeeze their competitors out of the retail markets." Id. From this, the Commission held that the plain language of the PUA does not support Ameritech's claim, nor could the Commission accept such a claim because "incumbent LECs should not be allowed the opportunity to squeeze their competitors out of the retail market[.]" Id. at 23-24

In sum, Staff argues that the above Commission decisions reveal two points. Staff IB at 24. First, the Commission has considerable authority to define the competitive service subject to imputation. Id. Second, the Commission's exercise of its authority to define those services, however, must be performed in a manner fully consistent with Section 13-505.1's fundamental purpose of preventing a price squeeze of competitive carriers. Id.

III. Whether UNEs Are "Services" or "Service Elements" for Purposes of the Imputation Requirement

A. Direct Testimony

Mr. Koch states that nothing in Section 13-505.1 or Code Part 792 suggests that UNEs are not services or service elements within the meaning of those provisions. Staff Ex. 1.0 at 8. Indeed, Code Section 792.20 specifically provides that "service" include the term "telecommunications service" as defines in Section 13-203. Id. Mr. Koch further notes that SBC has conceded that the retail NAL is subject to imputation. Id. at 7. Further, Mr. Koch notes that SBC's tariff states that the UNE loop is a "noncompetitive telecommunications service". Id. Finally, Mr. Koch observes that UNE loops are used in the provision of the retail business NAL. Id.

B. Rebuttal Testimony

Mr. Koch does not explicitly address this issue in his rebuttal testimony. *See* Staff Ex. 2.0.

C. Legal Argument in Briefs

As Staff observes elsewhere, the second part of the Commission' inquiry in this proceeding is to determine whether SBC Illinois' unbundled network elements ("UNEs") constitute "noncompetitive services" or "noncompetitive service elements" for purposes of the imputation test. Staff IB at 29. As with Staff's above discussion in Section II, this inquiry is one of statutory construction and those rules of construction are applicable to our discussion below. Id. This inquiry ultimately reveals that SBC Illinois' UNEs, *at minimum*, are "noncompetitive service elements" for purposes of imputation under Section 13-505.1. Id. Further, UNEs constitute "noncompetitive services" because SBC Illinois' tariff designates its unbundled loops as a noncompetitive telecommunications service, and that designation is dispositive for purposes of this proceeding. Id. These conclusions are fully supported by both Section 13-505.1 itself when construed in concert with other sections of Article XIII of the PUA, and by past Commission decisions. Id.

Staff notes that Section 13-505.1 provides that a particular competitive service offered by SBC Illinois is subject to imputation if that competitive service utilizes the same or functionally equivalent "noncompetitive services" or "noncompetitive service

elements" the company makes available to competitive carriers so those carriers can provide the same competitive service. Staff IB at 30. Neither Section 13-505.1 nor Article XIII of the Public Utilities Act, however, provides specific definitions for the terms "noncompetitive service" and "noncompetitive service elements" as used in the imputation provision. Id.

Illinois courts have long held that when a statute does not define a term, the court will assume that the word has its ordinary and popularly understood meaning. Staff IB at 30 (citations omitted). In doing so, a court must consider the legislative intent and the context in which the term is used. Id. In reading the text of a statute, the statutory provision should not be read in isolation, but in the context of the Act as a whole. Id. And, as a corollary, later statutory amendments to a statute should be read together with the original statutory provisions left unchanged by the legislature. Id. Moreover, in determining the intent of the legislature, the court may properly consider not only the language of the statute, but also the reason and necessity for the law, the evils sought to be remedied, and the purpose to be achieved. Id. Based on these rules, we first turn to Public Act 87-0856 to discern the meaning for the terms "noncompetitive service" and "noncompetitive service element" because that enactment produced the imputation requirement. Id.

Aside from adding Section 13-505.1 to Article XIII of the PUA, the Staff notes that Public Act 87-0856 also added and amended other sections of that Article. Staff IB at 31 (citations omitted). A review of those sections reveals that the General Assembly interchangeably used the terms "noncompetitive telecommunications service" and "noncompetitive service." Id. For example, newly-enacted Sections 13-505.1 through 13-506.1 all use the term "noncompetitive service" in either in their text, or their title, or both. Id. In particular, Sections 13-505.6 and 13-506.1 each use the term "noncompetitive service" in its title, but the term "noncompetitive telecommunications services" in its text. Section 13-506.1 uses both terms in its text. Id.

Staff argues that these facts indicate that when the General Assembly used the term "noncompetitive services" in Section 13-505.1, it intended for that term to mean "noncompetitive telecommunications services," as defined in Section 13-210. Staff IB at

31. As a result, it is Staff's position that SBC Illinois' competitive services are subject to imputation if that competitive service utilizes the same or functionally equivalent "noncompetitive telecommunications services" the company makes available to competitive carriers so they can provide the same competitive service. Id.

Staff argues that a "noncompetitive telecommunications service" is a telecommunications service that is not reasonably available from more than one provider. Staff IB at 32 (citations omitted). Staff notes that Section 13-502 provides SBC Illinois (or any other carrier) with the initial discretion to designate a given telecommunications service as either competitive or noncompetitive via tariff. Id. If SBC Illinois' tariff classification for a particular service has gone into effect without challenge (by either the Commission or another party), Staff asserts that the tariff classification is presumed correct and has the force and effect of law. Id. (citations omitted).

Staff notes that SBC Illinois' tariff has classified its UNE loops as a noncompetitive telecommunications service. Staff IB at 33 (citations omitted) Accordingly, SBC Illinois' tariff classification is dispositive for purposes of this proceeding, which, in turn, means the company's UNE Loops are deemed "noncompetitive services" for imputation purposes.

Staff observes that SBC Illinois and CUB urge the Commission to ignore this fact by pointing to FCC's decisions that hold that UNEs are not telecommunications services, but network elements. Staff IB at 33. What these parties fail to realize, according to Staff, is that the FCC's determination is completely inapposite for two reasons: First, the FCC made its determinations in the context of *federal law*, *not state law*; and second, FCC decisions are not binding on the Commission nor are they even relevant given the unique context of state law. Id., (citations omitted).

Even *assuming arguendo* that SBC Illinois' tariff classification were not dispositive to this proceeding—*and Staff is clear that it is*—the structure and text of Section 13-505.1 and Article XIII of the PUA indicate that SBC Illinois' UNE Loops are "noncompetitive service elements" for purposes of imputation. Staff IB at 33. To be sure, Public Act 87-0856 offers little guidance as to the meaning of the term. Id. After all, the term only appears in Sections 13-505.1 and 13-505.4 and only in the disjunctive after the term "noncompetitive service." Id. (citations omitted). Staff notes that, since neither

Article XIII nor the PUA itself defines the term "elements," the Commission must resort to its ordinary and popularly understood meaning. Id.

Staff observes that the term "elements" is ordinarily defined as "a constituent part; a distinct part of a composite device." Staff IB at 33. Given the context within which the term appears, Staff concludes that the General Assembly's use of the word "elements" obviously refers to the constituent or distinct noncompetitive part or noncompetitive parts that comprise a competitive telecommunications service. Id. at 33-34. Based upon these insights, the rhetorical question then becomes whether SBC Illinois' UNE Loops and Ports are, ordinarily speaking, constituent or distinct parts of a competitive telecommunications service. Id. at 34.The answer, in Staff's view, is that they very clearly are. Id. No party contests the veracity of this statement, not even SBC Illinois. Id.

Staff notes that in the Commission's *2002 Code Part 792 Order*, SBC Illinois conceded that its loops and ports are two of the three parts that comprise its offering of competitive business network access line service. Staff IB at 34. As SBC Illinois stated, "For example, *business network access lines have been subject to imputation for several years*. Individuals familiar with telecommunications and, therefore, Staff personnel understand that *network access lines are basically provisioned through a loop, port, and a cross connect*." Id. (citations omitted). Further, Staff notes that in response to Staff Data Request 1.11, SBC Illinois stated, "A retail network access line includes both a loop and switch port, therefore each is a necessary element of the network access line." Id.

Moreover, Staff argues that one need look no further than Section 13-216 of the PUA to draw the same conclusion that SBC Illinois' unbundled loops and ports are "noncompetitive service elements" for imputation purposes. Staff IB at 34. Likewise, Staff notes that Section 13-216 defines the term "network element" as, in pertinent part, "a facility or equipment used in the provision of a telecommunications service." Id. Thus, Staff argues, SBC Illinois' unbundled loops and ports unquestionably qualify as "network elements." Id.

In addition to the text and structure of Section 13-505.1 and Article XIII of the PUA, Staff notes that the Commission has also characterized an ILEC's unbundled loops as "noncompetitive services" or "noncompetitive service elements" for imputation purposes. Staff IB at 35. Staff points out that, in its *GTE North Order*, the Commission had to determine, among other things, whether GTE North's (now Verizon) CentraNet service, a PBX-type service, was subject to imputation. GTE North argued that since no competitors were offering a similar service in the company's service territory, the company's CentraNet service was not subject to imputation. Id. (citations omitted). There Staff agreed with GTE North's position. Id. AT&T and MCI, on the other hand, argued that the company's CentraNet service was subject to imputation irrespective of whether competing carriers directly competed with GTE North's service. Id. These parties reasoned that imputation was required because the competing carriers were

using the company's noncompetitive facilities to provide other types of competitive services. Id. Specifically, AT&T and MCI stated that they were using GTE North's "*local loops and access switching facilities*" to provide their competitive services. Id. (emphasis added)

Staff notes that the Commission agreed with AT&T and MCI and concluded that GTE North's CentraNet service was subject to imputation based on the plain language of Section 13-505.1. Staff IB at 36 (citations omitted). Staff observes that, aside from recounting GTE North's status as a carrier offering both competitive and noncompetitive services, the Commission held that the company's provisioning of local loops and access switching facilities to AT&T and MCI amounted to the offering of "non-competitive services or service elements" for imputation purposes. Id. Moreover, Staff observes, the Commission ordered GTE North to use its tariff price for local loops and access switching services in its imputation test for the company's CentraNet service. Id.

IV. Issues Related to Specific Tests

Mr. Koch testifies that the purpose of imputation is to foster competition in the telecommunications market in Illinois, by protecting against anti-competitive pricing in the form of a "price squeeze." Staff Ex. 1.0 at 9. Mr. Koch states that a price squeeze occurs when a supplier of an essential facility reduces the margin between the price it charges for that facility and the price that it charges for a competitive retail product using that facility. Id. at 9-10. This can result from either an increase in the price of the essential facility, or a decrease in the price of the competitive product. Id. at 10. The imputation test requires a minimal margin to exist between the essential facility and competitive product. Id.

Mr. Koch states that imputation prevents price squeezes in the following manner: when a competitor cannot provide a competitive service without the use of a noncompetitive service (or service element), the incumbent local exchange carrier that provides the noncompetitive service has a potential advantage over other carriers. Staff Ex. 1.0 at 10. Although the market for the *retail* service in question is classified as competitive, the incumbent carrier controls the market for *noncompetitive elements* necessary to provision the competitive service. Id. The imputed cost, in essence, is a proxy for the cost that the competitive carriers incur in order to provide the same service at retail. Id. If the incumbent carrier prices the competitive services below its imputed cost, it is assumed that competitive carriers will not be able to operate in the market. If the incumbent carrier is permitted to engage in this type of pricing, the market for the competitive service will become decreasingly competitive over time. Id. In order to prevent such practices and insure a level playing field for provision of the competitive

service, Section 13-505.1 places restrictions on the amount that the incumbent local exchange carrier can charge for the competitive service in the form of a price floor on the incumbent's retail provision of the service. Id. That price floor is equal to the imputed cost (to the competitor) of providing the service. Id. at 10-11.

Mr. Koch testifies that, under Code Section 792.30(c), imputation tests are required where two conditions are met. Staff Ex. 1.0 a 6. First, the service – in the case the retail business NAL – must be one subject to imputation, which is to say a competitive offering of a carrier that provides both competitive and non-competitive services. Id. at 6-7. There is no question that the retail business NAL is such a service. Id. Second, there must be a rate change for a noncompetitive service or service element that is utilized in the provision of the competitive service. In Mr. Koch's opinion, this is satisfied as well; the Commission recently authorized SBC to raise its UNE loop rates, and UNE loops are unquestionably utilized in the provision of the retail business NAL. Id.

Mr. Koch states that the imputation test establishes a statutorily required price floor that ensures that the cost incurred by a competitor to provide a service is at or below the rate charged by the incumbent carrier for the same retail service. Staff Ex. 1.0 at 11. Mr. Koch further testifies that the imputation test compares the retail revenue realized by the incumbent carrier for a particular service, to the imputed cost that reflects the costs that its competitors would face in offering the identical service. Id. To satisfy the test and thereby protect against a price squeeze, the imputed cost must be less than or equal to the retail revenue. Id. As a formula, this test could be expressed in its simplest form as:

Imputed Cost □ Retail Revenue

Id.

Mr. Koch observes that, once the exact service subject to imputation is defined, determining the retail revenue for the test is fairly straightforward. Staff Ex. 1.0 at 12. It usually is as simple as identifying the appropriate rate for the service from a tariff page. Id. For certain services, however, Mr. Koch states that it may be necessary to make assumptions regarding other factors that affect the rate level, such as minutes of use or mileage distances. Id. Mr. Koch observes that, mathematically, retail revenue for the test can usually be expressed as follows:

Retail Revenue = Tariff Rate for Service Subject to Imputation

Id.

Mr. Koch testifies that the imputed cost is defined in Section 13-505.1 and Code Part 792.40(a)(3) as the sum of the tariffed rates for the noncompetitive services

or services elements utilized to provide the service; plus the long run service incremental costs ("LRSICs") of facilities and functions that are utilized but not specifically tariffed; plus any other identifiable LRSICs associated with the provision of the service. Staff ex. 1.0 at 12. Mr. Koch further observes that, in practice, the task of developing imputed costs is a two-step process. Id. First, it is necessary to identify all of the various LRSIC values for the various imputed cost components. Id. Second, the LRSIC for all noncompetitive services or service elements must be replaced by their tariffed rates. Id. Mr. Koch expresses this mathematically as follows:

$$\text{Imputed Cost} = \left(\begin{array}{l}\text{LRSICs for all components of service} \\ \quad - \text{LRSICs for components that are considered noncompetitive services} \\ \quad + \text{tariffed rates for those components that are considered noncompetitive services}\end{array}\right)$$

Id. at 12-13

The formula for the imputation test then becomes:

$$\left(\begin{array}{l}\text{LRSICs for all components of service} \\ \quad - \text{LRSICs for components that are considered noncompetitive services} \\ \quad + \text{tariffed rates for those components that are considered noncompetitive}\end{array}\right) = \left(\begin{array}{l}\text{Tariff Rate for Service Subject to Imputation}\end{array}\right)$$

services

Id. at 13.

Mr. Koch testifies that the foundation for these imputation tests is the relationship between the UNE Loop rate and the retail network access line charge. Staff Ex. 1.0 at 13. When the other relevant cost and revenue elements are included, the imputation test in its most basic form is expressed as:

Imputed Cost = UNE Loop Rate + UNE Port Rate + Cross Connect Rate + SCF Retail Revenue = NAL+ EUCL

Id.

Mr. Koch advocates inclusion of end-user common line charge (EUCL) revenues in the test because the EUCL has been established to recover a portion of the cost for access lines, namely the interstate non-traffic sensitive costs of the NAL. Staff Ex. 1.0 at 14. Mr. Koch observes that SBCI charges a EUCL to all retail access line customers for which an imputation test is performed. Id. Mr. Koch further observes that the same interstate costs that are recovered by the EUCL on the retail side are also included in the TELRIC costs of the UNE loop and port developed by SBCI. Id. As such, Mr. Koch considers it only proper to include SBCI's EUCL rate on the revenue side of the equation. Id. Mr. Koch states that the tests provided by SBCI in this proceeding include the EUCL on the revenue side as well. Id.

Mr. Koch states that an imputation test must be performed on all competitive retail services that are subject to imputation and are affected by the increase in UNE loop rates. Staff Ex. 1.0 at 14. Mr. Koch points out that Section 13-502.5(b) provides that all retail telecommunications services provided to business end users by a telecommunications carrier subject to alternative regulation (such as SBCI) are competitive. Id. at 14-15. Mr. Koch observes that, in this instance, the services impacted are retail business access lines, ISDN lines, COPTS coin lines, COPTS basic lines, and STF lines and must therefore pass imputation. Id. at 15. Furthermore, Mr. Koch states that any and all competitive service packages that include, or "bundle" one or more of the types of lines described above with other telecommunications services must also pass imputation. Id. Staff, states Mr. Koch, believes that if the test is passed under the most basic of conditions (i.e. for a business customer that has no local or toll usage, does not subscribe to any central office features, and generates no switched access revenue for the company) then it follows that SBCI's more complex service offerings would likely meet the imputation criteria as well. Id.

Staff, states Mr. Koch, strongly believes that the statute requires an imputation test for every competitively tariffed service that can function on a stand-alone basis, and for every unique rate offered for that service in the tariff. Staff Ex. 1.0 at 15-

16 Specifically, Staff looks to the following portion of Section 13-505.1 as providing guidance on this issue:

> *"…the telecommunications* ***carrier shall satisfy an imputation test for each of its own competitive services****, switched interexchange services, or interexchange private line services, that utilize the same or functionally equivalent noncompetitive services or noncompetitive service elements."*
>
> *220 ILCS 5/13-505.1(a). emphasis added*

Mr. Koch observes that Code Part 792 also provides some guidance in that it consistently uses the phrase "for each service" when describing when an imputation test must be filed. Staff Ex. 1.0 at 16. Further, states Mr. Koch, SBCI's tariffs include separate and distinct definitions for services such as business NALs, local usage, and the various central office features. Id. Mr. Koch states that if one were to argue that these separately rated functionalities can only be considered as part of one service, it would follow that SBCI's entire competitive tariff has incorrectly defined these functionalities in error. Id.

Mr. Koch states that, if the basic imputation test is passed, this will protect against price squeezes. Staff Ex. 1.0 at 16. Mr. Koch testifies that, to include revenue for services other than the retail network access line in the test for the retail network access line would necessarily weaken the ability of the test to protect against price squeezes in the marketplace. Id. Mr. Koch observes that, as additional revenue for services other than the network access line are added to the imputation test, the effectiveness of the test becomes increasingly compromised precisely because these revenues from additional services *do not make up* or *are not part* of the network access line. Id. at 16-17. Furthermore, notes Mr. Koch, the revenue for services such as local usage and central office features normally have a significant level of margin (i.e., the revenue realized from them greatly exceeds the cost of production). Id. at 17. Mr. Koch opines that the danger of including additional levels of usage and features in the test for the business NAL is that, as the level of usage assumed in the test increases, the percentage of customers that achieve the level of usage in the test decreases. Id. Consequently, the percentage of customers receiving any protection against price squeezes decreases at the same time. Id.

Mr. Koch states that no usage or features should be used in the imputation test in this proceeding, since none are included in the SBC base retail business NAL rate. Staff Ex. 1.0 at 17.

Mr. Koch testifies that business customers can and do purchase the NAL. Staff EX. 1.0 at 18. For the basic access line services, Mr. Koch considers it quite likely

that some customers purchase the service for the sole purpose of having dial tone and have no intention of making outgoing telephone calls. Id. Mr. Koch gives as an example of this type of customer a small business such as a restaurant that offers take-out or delivery service. Id. Mr. Koch notes that use of a phone to make outgoing calls may cause a potential customer to not be able to reach the business to make a purchase, and therefore the manager of such an operation would have an incentive to prohibit such use of the phone. Id. Mr. Koch notes that another business may have the phone strictly as a means to have reliable access to emergency services. Id. Therefore, states Mr. Koch, to include any level of retail usage revenue in the test would render the test ineffective to protect the marketplace for such customers. Id.

Regardless of this, notes Mr. Koch, telephone customers have a wide range of demand for usage and features. Id. Thus, states Mr. Koch, to assume any level of demand for usage and features as being "appropriate" for the test necessarily weakens the test so that it cannot insure against price squeezes in markets for customers with lower call volumes than that assumed in the test. Id. Conversely, the only way to ensure that the market for all types of customers is protected against a price squeeze is to require that the test be passed under the most basic conditions. Id.

Mr. Koch observes that all of the LRSIC costs included on the imputed cost side have been replaced by rates for noncompetitive services. Staff Ex. 1.0 at 19. It is Staff's interpretation of Section 13-505.1 that whenever a noncompetitive rate exists for an imputed cost item, it must be included in the test. Id. Naturally, the UNE loop rate corresponds directly to the type of retail business network access line rate for which the test is being performed. Id. Mr. Koch notes that the UNE port rate, cross connect rate, and service connection fee are all essential items in retail access line provisioning, as well, and each has its own corresponding noncompetitive tariff rate. Id.

A. Issues Common to the Parties' Proposed Imputation Tests

Mr. Koch describes SBCI's tests as follows:

- Scenario (1), which includes revenue for network access lines, usage, and features;
- Scenario (2), which includes only revenue for the stand-alone network access line service; and
- Scenario (3), which has identical revenue to the first scenario but develops its imputed costs via the UNE-Platform.

Staff Ex. 1.0 at 20-21

Mr. Koch generally endorses the tests performed by Joint CLEC witness James Webber, as being generally consistent with the ones that Mr. Koch himself submitted. Staff Ex. 2.0 at 2-3.

Mr. Koch observes that the results of the first two scenarios are included in Schedule ELP-D1 to SBC Illinois Exhibit 1.0, while the results of the third scenario are included in Schedule ELP-D2. Staff Ex. 1.0 at 21. Mr. Koch notes that the imputation tests were filed as work papers supporting the testimony of SBCI witness Eric Panfil. Id. Mr. Koch further notes that the twelve tests in each scenario are basically a set of tests for four separate retail services in each of the three access areas in SBCI's service territory: business NAL, ISDN direct, COPTS coin line, and COPTS basic line. Id.

Mr. Koch attached to his testimony the statutorily required imputation tests for this proceeding. Staff Ex. 1.0, Schedule 1.03. Based on these tests, Mr. Koch observes that Business NALs in Access Area B and C, as well as all of the COPTS Coin and COPTS Basic fail the imputation test required by Illinois law. Staff Ex. 1.0 at 27.

1. Inclusion of Nonrecurring Charges ("NRCs")

a. Direct Testimony

Mr. Koch states that Staff is strongly of the opinion that Section 13-505.1 requires an imputation test – on a stand-alone basis – be performed and passed for every competitively tariffed service that can function on a stand-alone basis. Staff Ex. 1.0 at 15-16. Inclusion of revenues from additional sources is improper. Id. at 16.

b. Rebuttal Testimony

Mr. Koch states that it is improper to use average revenues from multiple services in conducting an imputation analysis for the retail business NAL. Staff Ex. 2.0 at 5-7.

c. Legal Argument in Briefs

Staff witness Mr. Koch does not include NRCs in his imputation tests. In the process of constructing his tests, Mr. Koch found it unnecessary and improper to include such items. Mr. Koch excluded NRCs from his tests because the rate for the business network access line service is not designed to recover the upfront cost of establishing the line connection. Staff Ex. 1.0 at 16. Costs associated with establishing service are recovered separately in SBC's line connection and service

order charges. The rates for NRCs are designed to recover the entire cost associated with establishing service, and are paid on an upfront basis when a customer commences service. There is, accordingly, no need for NRC charges to be included in the retail business NAL imputation test. The Staff, moreover, has consistently excluded NRCs or, for that matter, any separately rated functionality from its imputation tests for NALs in prior proceedings. See generally, the Direct Testimony of Patrick Phipps in Docket 98-0860 (Staff Ex. 5.0); the Direct Testimony of Robert Koch in Docket 02-0864 (Staff Ex. 4.0). Staff IB at 36.

Staff noted that Joint CLEC witness Mr. Webber does not take a position as to whether it is appropriate to include NRCs and their corresponding costs in the imputation test. Rather, he indicates that SBC often waives or discounts NRCs in an attempt to entice customers, and that this fact is not reflected in SBC's imputation analysis in this proceeding. Joint CLEC Ex. 1.0 at 43. Mr. Webber concludes that SBC's use of NRC revenue in its tests skews any meaningful analysis and should be removed. *Id*. However, he does not go so far as to indicate that the costs associated with initially establishing service should also be removed. Staff IB at 37.

In contrast, Staff points out that SBC witness Mr. Panfil disagrees with Mr. Webber's assertion that NRCs should be discounted to reflect the Company's retail promotions. SBCI Ex. 1.1 at 22, 23. Mr. Panfil claims that when SBC offers such promotions, it must file imputation tests showing that the retail service passes a separate imputation test reflecting that promotion. Staff agrees with Mr. Panfil in that, when the Company offers such a promotion, it must make a showing that imputation concerns are satisfied. As noted above, however, the Staff does not believe that NRCs should be a part of the stand-alone imputation test primarily because NRCs are designed to recover their own costs. However, in instances were these NRCs are waived as a promotional offering, it is necessary that these costs be recovered via the recurring NAL rates. Under these limited circumstances, Staff believes that an imputation test that includes NRC revenue and costs would be necessary. Staff IB at 37.

2. Use of LRSIC or TELRIC Costs for the Port

a. Direct Testimony

Mr. Koch testifies that SBC's scenario 2 is based on "narrow" revenue assumptions, and is therefore acceptable to that extent. Staff Ex. 1.0 at 25. However, Mr. Koch notes that the imputed cost per NAL is developed using the long run service incremental cost ("LRSIC") of the port, rather than tariffed noncompetitive UNE rate. Id. It is Mr. Koch's opinion that this is improper. Id.

Mr. Koch testifies that the UNE port rate rather than the port LRSIC should be used for the following reasons: the port is a noncompetitive element of the retail business access line. Staff Ex. 1.0 at 26. Accordingly, because there is a tariff rate for the UNE port, it is Staff's reading of Section 13-505.1 and Code Part 792.40(c) that the tariff rate must be imputed in the test. Id. Further, Staff notes that CLECs are not charged the LRSIC when they order the port functionality; rather, they are charged the UNE port rate. Id. Imputation is intended to prevent a price squeeze, and this is only accomplished by choosing the costs that are most reflective of those faced by the CLECs. Id. Because the LRSIC of the port is lower than the UNE port rate, the imputed cost presented in this scenario by SBCI is underestimated. Id.

b. Rebuttal Testimony

Mr. Koch does not address this matter in his rebuttal testimony. See Staff Ex. 2.0.

c. Legal Argument in Briefs

Staff contends that the port is a necessary element of the retail business access line. This element has a specific noncompetitive tariff rate in the UNE port. Therefore, as Mr. Koch explained, Section 13-505.1 of the PUA and Code Part 792.40(c) require that the tariff rate must be imputed in the test. Staff Exhibit 1.0 at 12, 19, 26. Mr. Koch further testified that CLECs are not charged the LRSIC when they order the port functionality; rather, they are charged the UNE port rate. Id., at 26. Imputation is intended to prevent a price squeeze, and this is only accomplished by choosing the costs that are most reflective of those faced by the CLECs. Because the LRSIC of the port is lower than the UNE port rate, the imputed cost presented in this scenario by SBC is underestimated. Id. Joint CLEC witness Webber agrees with Mr. Koch's assessment. Joint CLEC Ex. 1.0 at 39; Staff IB at 38.

Staff noted that in direct testimony, Mr. Panfil argues that UNEs are not services or service elements. SBCI Ex. 1.0 at 4. Mr. Panfil does not go so far as to specifically reject the need for any imputation tests resulting from the UNE loop increases ordered in Docket 02-0864. Id. Rather, he merely indicates that the need for a test is primarily a legal issue to be addressed in SBC's legal brief. Id. It was not until Staff specifically challenged SBC to make a policy statement regarding this issue (Staff Ex. 1.0 at 9), that Mr. Panfil admitted in rebuttal testimony that SBC does not believe that imputation tests have been triggered as a result of Docket 02-0864. Staff IB at 38.

Staff also pointed out that SBC conveniently uses its determination that UNEs are not services or service elements to argue that the UNE port should not be imputed on the cost side of our tests. SBCI Ex. 1.1 at 6. Further, Mr. Panfil points to the fact that some CLECs actually provision their own switch to conclude that UNE ports should

not be part of the imputation test. SBCI Ex. 1.1 at 26, 27. Also, Mr. Panfil challenges Mr. Koch's and Mr. Webber's assertions that the UNE port must be in the imputation test because it has been designated as noncompetitive in SBC's tariff. Id. Staff is not persuaded by Mr. Panfil's argument. Mr. Panfil is simply not considering the specific requirements of the statute and code part. Staff IB at 38-39.

B. Issues Specific to SBC Illinois' Proposed "Broad" Imputation Test

Mr. Koch observes that SBC scenario 1 – the "broad" test, including revenues from usage and vertical features – is improper. Staff Ex. 1.0 generally, and at 22 et seq. Mr. Koch notes that, in addition to the revenue for the retail NAL and the End User Common Line Charge (EUCL) provided in the Staff tests, this SBC scenario also includes revenues for average local usage, toll, and central office features on the retail side of the business NAL and ISDN direct imputation tests. Id. at 22. SBC Scenario 1 does not provide a test for any one specific service that is offered in the company's retail tariffs. Id. Rather, it combines revenues from several separately tariffed services. Id.

In Mr. Koch's opinion, the revenue assumptions included in SBCI's Scenario 1 would render the test completely ineffective. Staff Ex. 1.0 at 23. Mr. Koch testifies that these imputation tests would no longer be useful to protect CLECs from price squeezes for business NALs – in other words, the tests would no longer serve the purpose for which imputation was established. Id. Since the test includes revenues from several individually tariffed services, Mr. Koch asserts that it does not constitute a useful or valid imputation test for any one of those services. Id. In Mr. Koch's opinion, this is clearly illustrated in the table contained in his direct testimony at page 23, which lists the margin by which the rates in each access area pass SBCI's test along side the corresponding retail rates for business network access lines. Id. Mr. Koch notes that, because the margin exceeds the access line rates in each access area, each of these access line rates could be reduced to *zero* and still pass SBCI's imputation test. Id. Mr. Koch points out that, as currently configured, the SBC test advanced in scenario 1 would only protect very high-volume customers from the effect of a price squeeze. Id

Mr. Koch notes that SBC scenario 3 is essentially the same as the first scenario, except that the UNE port is included in the imputed cost side of the test as opposed to the UNE LRSIC. Staff EX. 1.0 at 26. Mr. Koch observes that the revenue side of the tests in this scenario is identical to the revenue side in the Scenario 1 tests and for the same reasons leads to an ineffective test due to the inappropriate inclusion of revenue for usage and features. Id. Mr. Koch further observes that the imputed cost side of the test is improved because it includes the UNE port rate. Id. However, Mr. Koch points out that, just as the revenue side of test inappropriately includes the usage and features revenue, the imputed cost side of the test in this scenario includes the same

inappropriate assumptions regarding the average level of usage and features. Id. Therefore, in Mr. Koch's opinion, the tests provided under this scenario are also deficient. Id.

1. Accuracy of Data Used to Develop Usage, Feature and Switched Access Revenues

a. Direct Testimony

b. Rebuttal Testimony

c. Legal Argument in Briefs

Staff notes that both it and the Joint CLECs are of the opinion that usage, feature, and switched access revenue do not belong in the imputation test. Staff Ex. 1.0, at 15-16; Joint CLEC Ex. 1.0, at 10-13. Nonetheless, Joint CLEC witness Webber took issue with the accuracy of the data SBC provided to develop its usage, feature, and switched access revenue figures used in its imputation tests. Id., at 41-45. Chief amongst Mr. Webber's complaints were that the data provided did not come from billed activity, and a concern that 80% of usage revenue presented in SBC's tests did not include discounts. Staff IB at 39.

Staff did not take issue with the source of the data provided by SBC. The data source in question is the annual aggregate revenue test filing, which SBC routinely uses as a source for demand figures. Staff finds this to be an acceptable source. Staff also did not address Mr. Webber's concern that 80% of SBC's usage revenue, as used in its imputed cost analysis, did not contain discounts. Regardless, Staff is of the opinion that, if SBC failed to include an accurate portrayal of usage discounts in imputation tests, the tests would necessarily be skewed. As Staff argues elsewhere in this brief, it does not believe that the revenue for usage and features should be included in the test as a threshold matter. *See, generally,* Section II of this brief, as well as Subsection (B)(2) below. If the Commission were to decide that this revenue should be in the test, however, then it would only be appropriate to reflect the revenue the Company actually receives after discounts have been factored. Staff IB 39-40.

SBC witness Mr. Panfil argues that the exclusion of certain discounts is not a significant issue, as the percentage of its total customer base that receives discounts is low due to the fact that term commitments are necessary to obtain such discounts. In as much as these discounts are not included in SBC's imputed cost calculation, the revenue for these figures will be inflated. Staff is therefore of the opinion that such discounts for usage, where they may exist, would need to be factored into the imputed cost if SBC's proposed tests were accepted. Staff IB at 40.

2. Use of Averages to Develop Usage, Feature and Switched Access Revenues

a. Direct Testimony

Mr. Koch notes that, even if the margins by which SBCI's proposed test passed imputation were relatively small, the use of average revenue and costs for usage and central office features would not be proper. Staff Ex. 1.0 at 24. Mr. Koch states that Section 13-505.1 requires that each service must pass, and it can only do so on a stand-alone basis, and that any level of usage and feature revenue would necessarily weaken the ability of the test to provide against a price squeeze. Id.

Staff notes that over half of SBC's business NAL customers generate less than average usage revenue and generate less than average revenue for central office features. Staff Ex. 1.0 at 24. Mr. Koch considers it important to note that, by including these additional service revenues on the revenue side of the test, it follows that the imputed cost side of the test will necessarily also inappropriately have values for these services. Id. Mr. Koch testifies that, just as using average revenue for usage and features is inappropriate, so is including average costs for these services; such averages simply do not belong in the test. Id.

Mr. Koch observes that SBCI claims that, because CLECs typically target high volume customers, the figures used in the SBCI tests are probably underestimated, a claim which Mr. Koch notes is so far unsubstantiated. Staff Ex. 1.0 at 25. Further, Mr. Koch points out that Section 13-505.1 and Code Part 792 do not address whether a typical CLEC currently operating in the market is doing so at a profit; rather, the statute and the Code Part require that the test be passed for the specific retail services in *all* cases, and not just under the most favorable of conditions for the ILEC. Id.

b. Rebuttal Testimony

Mr. Koch considers Citizens Utility Board witness William Dunkel's position that average revenue from multiple services should be used in the imputation test to be improper. Staff Ex. 2.0 at 7.

c. Legal Argument in Briefs

Staff points out that the imputation tests proposed by SBC in this proceeding include average revenues for local usage, central office features, and switched access in addition to the retail NAL and EUCL. SBCI Ex. 1.0 at 7. By combining revenues from several separately tariffed services, such tests do not comply with the requirements of Section 13-505.1. Staff Ex. 1.0, at 16. As was discussed above in Section II of this brief, tests must be performed on a service-by-service basis as a statutory condition.

The generous inclusion of such revenue diminishes the ability of the test to fulfill its statutory intent – to prevent against price squeeze. Staff IB at 40-41.

In direct testimony, Staff witness Mr. Koch testified that the assumptions in SBC's proposed imputation tests render the tests useless. Staff Ex. 1.0, at 16-17, 24. Mr. Koch provided a table in direct testimony (*Id*., at 23), which lists the margin by which SBC witness Panfil's proposed tests for retail business NAL pass imputation (*i.e*. the revenue surplus) alongside the retail rates for SBC's retail NALs. This table clearly indicates that SBC's retail business NALs would pass the imputation test proposed by Mr. Panfil even if the rates for this service were reduced to zero in each access area.

Staff found Mr. Koch's table to be a dramatic indictment of SBC's approach to constructing imputation tests. Reducing retail rates to zero is an extreme example, as rates could not possibly be reduced further. Naturally, such an action would be prohibited by the Commission's cost of service rules. Yet Mr. Koch's hypothetical example clearly shows that SBC's imputation test would not protect against a price squeeze even under such an implausible scenario. Staff IB at 41.

SBC, by using the averages that it does in its tests, in effect is saying that a prize squeeze analysis is not relevant unless it becomes unprofitable to offer service to its highest margin customers. In response to Staff Data Request RFK 1.05, SBC indicates that a majority of its business NAL customers have less than average usage revenue and that majority of its business NAL customers have less than average revenue for central office features. This demonstrates that SBC's test sets the bar mathematically at a level were only the market for the top 34% to 40% of its customers would ever be protected from a price squeeze. Such protection would only occur if imputed costs were to rise dramatically from their current level, as the table above shows that there is a very comfortable margin of revenue over imputed cost presently. Staff IB at 42.

Nonetheless, Staff stresses that the tests proposed by SBC would not be appropriate even if the margins were not as large as shown in the table above. The retail NAL must pass imputation on a stand-alone basis, and the inclusion of any extraneous revenues from other services would necessarily weaken the ability of the test to protect against a price squeeze for the retail NAL. Staff IB at 42.

Staff noted that Joint CLEC witness Webber agrees with Staff regarding the use of average revenue for usage, features, and switched access in the imputation test. Specifically, Mr. Webber identifies as being particularly relevant Staff's conclusions that Section13-505.1 of the PUA requires that imputation be done on a stand-alone basis; including revenue from services other than the NAL necessarily weakens the ability the test to protect against a price squeeze; and the "broad" tests proposed by SBC do not comply with Section 13-505.1 of the PUA and Code Part 792. Joint CLEC Ex. 2.0 at 2-3. Mr. Webber also provides an extensive case history that shows that the Commission

has consistently chosen to implement imputation on a stand-alone basis. *Id*., at 16-20. Although Staff did not provide this Commission imputation case history in its direct testimony, it finds such information relevant and further compelling evidence to support its position regarding the proper form of the test. Further, Staff has provided its own extensive review of prior Commission precedent as part of its statutory construction analysis in Section II of this brief. Staff IB at 42-43.

Staff noted that in defense of its own imputation tests, SBC witness Panfil aggressively argues against Staff's approach. Mr. Panfil characterizes Staff's approach as being unduly rigid, claiming that the network access line does not provide any functionality on a stand-alone basis. SBCI Ex. 1.1 at 8. As Staff witness Koch explains in direct testimony, stand-alone telephone service does provide functionality to consumers, such as access to 9-1-1 services and the ability to receive incoming calls. Staff Ex. 1.0 at 18. It is reasonable to assume such customers exist, and that is not acceptable for a price-squeeze to occur that would effectively eliminate the ability of CLECs to compete for these customers. Mr. Panfil counters this argument, as made by Mr. Koch, by claiming that he "…seems to waffle between describing imputation as being intended to protect customers and competitors." SBCI Ex. 1.1 at 14. This is clearly a misreading of Mr. Koch's testimony. Mr. Koch is in solid agreement with SBC that imputation is intended to protect the marketplace for competition. What Mr. Koch identifies as a problem is that SBC's test does not protect the market because competitors would have no incentive to provide service to low volume customers. Staff IB at 43.

Mr. Panfil also disagrees with Staff witness Mr. Koch's assertion that imputation is required for every competitive service with a unique tariffed rate. Id., at 9. Mr. Panfil provides the example of Band B usage, which has unique rates for initial and subsequent minutes, peak and off-peak rates, etc., as a counter example. Id. Here again, Mr. Panfil labors under a misunderstanding of Staff's position. The important concept that Mr. Panfil fails to comprehend is that the service must function on a stand-alone basis first, prior to the examination of whatever unique rates for the service that may exist. It is obvious that the initial minute and subsequent minutes of Band B usage do not function on a stand-alone basis. If a customer opts to select SBC as its provider of Band B usage, and chooses the *ala carte* rates for this service, they must be examined as a whole. Staff agrees that in the case of Band B usage, the entire table of applicable rates must be considered in conjunction because the individual rates cannot be offered in isolation. Staff views this similarly to the EUCL that must be purchased in addition to the retail business NAL. As explained in Mr. Koch's testimony, neither the EUCL nor the NAL can be purchased in isolation, and as such, it is appropriate to aggregate their revenue for the purpose of imputation. Staff IB at 43-44.

Staff also noted that Mr. Panfil argues that SBC's imputation test is more consistent with the FCC's approach to a price squeeze analysis than the Staff's

approach. SBCI Ex. 1.1 at 13, 14. Although this may be true, it is not relevant. As has been demonstrated elsewhere in this brief, Staff's approach to imputation is the byproduct of the Illinois statute and prior decisions of the Illinois Commerce Commission. Further, the price squeeze analysis provided by Staff in this proceeding is reflective of the unique price and cost structure of SBC in Illinois. As such, any price squeeze analysis performed by the FCC in regard to rate structures outside of Illinois are simply not useful for our purposes. Staff IB at 44.

V. Rate Design Issues for Business Services Generally

A. Rate Options If Section 13-505.1 Is Deemed Not Satisfied

1. Direct Testimony

Mr. Koch notes that there are five possible alternatives to bring SBC's retail business NAL into compliance with imputation:

> Alternative 1: Restructure retail business NAL rates by creating a kind of base rate "package" for business POTS and ISDN NALs. The base rate for the NAL would increase to the point were these services pass imputation and to offset the increase, local usage and/or some central office features would be provided to customers as part of the base rates. This new "base rate package" should be developed in such a way that retail customers receive the combined services for a price equal to or lower than the rates that would be possible currently. In addition, SBCI would have to stop providing business NALs on a stand-alone basis.
>
> Staff Ex. 1.0 at 28
>
> Alternative 2: Reduce UNE loop rates in Access Area B and C.

Id.

> Alternative 3: Increase business NAL rates as in Remedy 1 but, in order to ensure that business customers "remain whole," also reduce rates for other services so that the combined impact is revenue neutral. SBCI offers a similar proposal in this proceeding as a remedy to imputation.
>
> Id. at 28-29
>
> Alternative 4: Increase business NAL rates in Access Area B and C.
>
> Id. at 29.

Alternative 5: Without providing specific direction on how to do so, require SBCI to file tariffs that would bring SBCI's retail business NAL rates into compliance with Section 13-505.1 and Code Part 792.

Id.

2. Rebuttal Testimony

Mr. Koch notes that a rate design alternative proposed by Joint CLEC witness James Webber, Joint CLEC Ex. 1.0, specifically, that SBC withdraw any service that does not pass imputation, might negatively impact customers. Staff Ex. 2.0 at 4.

3. Legal Argument in Briefs

B. Implementation Issues: the Under 4-Line Rate Cap in Section 13-502.5

1. Direct Testimony

2. Rebuttal Testimony

3. Legal Argument in Briefs

Staff noted that, as is clear from the above, SBC's business NAL rates do not satisfy imputation. They must, accordingly, be redesigned or raised. In deciding this case, the Commission need only make the appropriate finding – that SBC's business NAL rates do not satisfy imputation under Staff's proposed narrow imputation test – and leave it to SBC to design rates in such a way that its business rates – however configured or designed – satisfy the imputation requirement. Staff Ex. 1.0 at 29. The Staff notes that the Commission can quite properly do this; there is nothing in Section 13-505.1, or in Code Part 792, that requires the Commission to do anything more than make a finding regarding whether imputation is satisfied. See 220 ILCS 5/13-505.1, 83 Ill. Admin. Code §792.10, *et seq*. (Commission need only determine whether imputation is satisfied). The Commission has reached precisely this conclusion in the past. *See* MCI Complaint Order at 32 (Lexis pagination) ("Certainly, Ameritech can implement an AAD/GID offering that results in reasonable price differences between customer classes; however Ameritech must demonstrate that the offering passes a stand alone imputation test"); GTE North Order at 155 (Lexis pagination) ("It is within the Company's discretion to pass an imputation test by reducing GTE's imputed costs, increasing end user rates, or by some combination thereof."). Staff IB at 45.

Moreover, SBC is in possession of the information necessary to design compliant rates. The Commission can (and should) therefore, quite properly place the onus upon SBC to find an appropriate solution. In this regard, there are several options, of which the following list is certainly not exhaustive. Id.

A. Rate Options If Section 13-505.1 Is Deemed Not Satisfied

There are several ways that SBC's business NAL rates can be made to satisfy the imputation requirement. These include, but are not necessarily limited to, the alternatives discussed in Mr. Koch's testimony, which are:

1. Redesign of SBC's Rate Structure

Staff noted that first, SBC might restructure retail business NAL rates by creating a kind of base rate "package" for business POTS and ISDN NALs. Staff Ex. 1.0 at 28. Under this proposal, SBC would raise the base rate for the NAL to the point where these services pass imputation. Id. To offset this increase in price, SBC would provide customers with local usage and/or some central office features as part of the base rates. Id. Ideally, this new "base rate package" should be developed in such a way that retail customers receive the combined services for a price equal to or lower than the rates that would be possible currently. Staff IB at 46.

If SBC elects to adopt this solution, it must cease providing business NALs on a stand-alone basis. Id. As noted above, without more, the stand-alone NAL does not pass imputation. Id.

Staff points out, however, that care should be taken not to confuse this potential rate design alternative with the Joint CLECs' proposal that SBC might cease providing retail business service altogether. Joint CLEC Ex. 1.0 at 49-50. Under the alternative to which Staff refers, SBC would continue to offer competitive business service, but would not offer the business NAL on a stand-alone basis. Staff IB at 46.

2. Reduce UNE Loop Rates

As a second alternative, SBC might reduce its UNE loop rates in all access areas. Staff Ex. 1.0 at 28. Were SBC to adopt this approach, the imputation problem would be quickly and easily solved, however this would be inconsistent with the Commission's Order in Docket 02-0864. Staff IB at 46.

Staff pointed out that the Commission determined, only five months ago, and after an extended and hotly contested proceeding, that SBC's UNE loop rates were in fact too low, and permitted SBC to raise them. *See* SBC UNE Loop Order. The

Commission made this decision based in part upon its conclusion that SBC's costs for provisioning the UNE loop had increased. Id. Indeed, this proceeding is convened solely for the purpose of determining how to deal with imputation questions caused by those very UNE loop increases. Id.

Moreover, under Section 252(d)(2)(A) of the federal Telecommunications Act, SBC is entitled to recover the costs it incurs in providing UNEs, including the UNE loop, to other telecommunications carriers. 47 U.S.C. §252(d)(2)(A). To the extent that the Commission determines – as it has, in the *UNE Loop Order* – that SBC's costs for providing the UNE loop have increased, it cannot, without inviting a conflict with federal law, reduce SBC's UNE loop rates – which are, after all cost based – for the purpose of bringing those rates into compliance with a state law imputation requirement.[1] Staff IB at 47.

[1] The Staff notes, however, that a conflict of law will exist only to the extent that SBC chooses to raise one.

Staff noted that the Joint CLECs propose a solution very similar to reducing UNE rates:[2] specifically, that, where SBC's imputed cost for a service exceeds the associated revenue for that service, the Commission should direct SBC to credit CLECs with the difference. Joint CLEC Ex. 1.0 at 49-50. It should be noted that this proposal has all of the legal and practical problems described above, as well as potentially violating the filed rate doctrine, which renders it unlawful for public utilities, and telecommunications carriers providing non-competitive services to: "refund or remit, directly or indirectly, in any manner or by any device, any portion of the rates or other charges so specified, nor extend to any corporation or person any form of contract or agreement or any rule or regulation or any facility or privilege except such as are regularly and uniformly extended to all corporations and persons." 220 ILCS 5/9-240; *see also* 220 ILCS 5/13-101 (Section 9-240 applicable to telecommunications carriers providing non-competitive services). Staff IB at 47-48.

---

[2] The Joint CLECs also propose reducing UNE loop rates. Joint CLEC Ex. 1.0 at 47-50.

Staff opined that there are other flaws inherent in the Joint CLECs' proposal. First, it would unnecessarily complicate the rate structure, making it very difficult to determine what UNE loop rates actually would be, since they could not be determined by reference to the tariff – the traditional way to determine what rates are. Staff Ex. 2.0 at 3. Second, issuance of rebates or refunds – however characterized – begin to have the look and feel of subsidies, something the Commission has long opposed. Staff IB at 48.

3. "Make Whole" Rate Realignment of Rates

Staff noted that under the third alternative SBC might increase its retail business NAL rates in the manner proposed above, but, in order to ensure that business customers "remain whole," also reduce rates for other services so that the combined impact is revenue neutral. Staff Ex. 1.0 at 28. SBC notes the existence of a similar rate design alternative. Staff IB at 48.

Staff pointed out, however, that while such a proposal would, if adopted, be revenue-neutral to SBC, it would not be revenue-neutral as to individual customers. SBC Ex. 1.0 at 25. It would result in certain users paying increased rates. Staff Ex. 1.0; SBC Ex. 1.0 at 22-29. Specifically, those customers who make few calls and subscribe to no vertical services would pay relatively more for service, while those customers who make a larger number of calls and subscribe to vertical services would pay relatively less. Staff IB at 48-49.

4. Increase Retail Rates

Staff noted that a fourth rate design alternative would be for SBC to raise its retail business NAL rates in those access areas, and for those access line types, which do not satisfy imputation. A key difficulty with this alternative is the fact that Section 13-502.5(b) of the Public Utilities Act caps rates for certain business customers. 220 ILCS 5/13-502.5. The Staff recommends that the Commission order SBC to file rates for business NAL rates designed in such a way as to satisfy imputation and all other applicable laws by a date certain after entry of its Order in this proceeding. Staff IB at 49.

B. Implementation Issues: the Rate Cap for Businesses With 4 or Fewer Access Lines in Section 13-502.5

Staff noted that the prospective solutions for the failure of SBC's business NAL to satisfy imputation must be considered in light of Section 13-502.5. To the extent that SBC's rates for business NAL services provided to retail business end users with four or fewer access lines are capped at their May 1, 2001 levels, implementation of some of the options above will be problematic. Indeed, SBC raises precisely such contentions,

suggesting that its billing systems would have to be extensively revamped to differentiate between customers subject to, or not subject to, the four or fewer access line rate cap. SBC Ex. 1.0 at 30-32. SBC accordingly suggests deferring any rate changes to July 1, 2005. Staff IB at 50.

Staff pointed out that the General Assembly enacted Section 13-502.5 in June of 2001. *See* P.A. 92-22 (effective date of July 1, 2001). Accordingly, although SBC has had over three years to accommodate its billing systems to the existence of a legally mandated class of small business customers, it apparently has not done so. Its failure to do so cannot now serve as a basis for permitting it to violate imputation. Deferring resolution of this issue prejudices the CLECs that are placed at a competitive disadvantage for a period of something like half a year. The Commission should therefore disregard SBC's recommendation that the Commission should wait to July 1, 2005 to resolve this matter. Staff IB at 50-51.

Staff also noted that it might also be argued that the statutory imputation requirement conflicts with Section 13-502.5, since Section 13-502.5 caps certain rates, thereby arguably preventing SBC from bringing these rates into line with imputation. This argument is untenable, at least with respect to the application of certain of the possible alternatives the Commission has available to it. Staff IB at 51.

Staff provided the following illustration; Section 13-502.5 provides that: "Rates for retail telecommunications services provided to business end users with 4 or fewer access lines shall not exceed the rates the carrier charged for those services on May 1, 2001[.]" 220 ILCS 5/13-502.5(b). However, to the extent that SBC ceases to offer the business NAL on a stand-alone basis, this provision need not be implicated, since nothing in Section 13-502.5 prohibits discontinuing a service offering. Likewise, if a package of services is offered, consistent with the alternative noted by Staff above, such a package could be designed in such a way that the total package both passes imputation, and does not constitute an increase from the rates in effect on May 1, 2001. Again, it must be stressed that SBC, and no other party, is responsible for designing rates in such a way that they comply with all applicable laws. Staff IB at 51.

Staff pointed out that the Section 13-502.5 rate cap provision is not as much in conflict with the statutorily mandated imputation requirements as it simply limits the options available to SBC in finding a solution. SBC's failure to implement billing systems capable of differentiating between two legally mandated classes of business customers further hinders this effort. SBC is barred from raising the retail rates that it charges business customers with 4 or fewer access lines until July 1, 2005. By extension, because SBC's billing system is not able to distinguish between customers, this further calls into question SBC's ability to implement any sort of retail rate increase without violating the 13-502.5 rate cap. It appears that SBC is not in a position, based on its own testimony, to increase stand-alone business NAL rates, since it is unable to

distinguish between customers with four or fewer access lines, and those with five or more, and therefore unable to ensure that stand-alone business NAL rates will not increase for the former group. However, this problem is SBC's to solve; the Commission need only determine that SBC has not satisfied imputation. Staff IB at 51-52.

VI. Payphone Issues

A. Interrelationship with Docket No. 98-0195

1. Direct Testimony

In his direct testimony, Mr. Koch stated that rates for COPTS (coin operated pay telephone service had been set by the Commission in its Payphone Order, using the federally mandated New Services Test. Staff Ex. 1.0 at 30. He further noted that, when the Commission, in its UNE Loop Order, authorized SBC to recover higher TELRICs for UNE loops, this increase, combined with the fact that the LRSICs, upon which SBC's COPTS rates are based, were not simultaneously updated, has the effect of causing SBC COPTS rates to fail imputation. Id.

2. Rebuttal Testimony

Mr. Koch did not address this issue in his rebuttal testimony. See Staff Ex. 2.0.

3. Legal Argument in Briefs

A. Interrelationship with Docket No. 98-0195

Staff noted that Independent payphone providers (hereafter "IPPs") purchase access to the telecommunications network from SBC as the ILEC, and resell that network access to the public through public payphones. Interim *Order* at 2, Illinois Commerce Commission On its Own Motion: Investigation Into Certain Payphone Issues as Directed in Docket 97-0225, ICC Docket No. 98-0195 (November 12, 2003) (hereafter "Payphone Order"). IPPs are considered retail business customers rather than telecommunications carriers. *First Report And Order*, ¶876, In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers, FCC No. 96-325, CC Docket No. 96-98; CC Docket No. 95-185, 11 FCC Rcd 15499; 1996 FCC LEXIS 4312; 4 Comm. Reg. (P & F) 1 (August 8, 1996) (hereafter "Local Competition Order"); SBC Ex. 1.0 at 32, *et seq*. Accordingly, SBC must submit, and in fact has submitted, imputation studies for its COPTS ("coin-operated pay telephone service"). SBC Ex. 1.0 at 32, *et seq*. Staff IB at 52-53.

Staff explained, however, that it is vital to understand that network services rates ILECs charge to IPPS must satisfy certain federal requirements. As part of the Telecommunications Act of 1996, Congress enacted Section 276, entitled "Provision of Payphone Service". 47 U.S.C. §276. Pursuant to subsection (b)(1)(C) of Section 276, the FCC directed the use of the existing New Services Test under the authority of Section 276 of TA '96. *See Report and Order*, In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996 / Policies and Rules Concerning Operator Service Access and Pay Telephone Compensation, FCC No. 96-388, CC Docket No. 96-128; CC Docket. No. 91-35, 11 FCC Rcd 20541; 1996 FCC LEXIS 5261; 4 Comm. Reg. (P & F) 938 (September 20, 1996) (hereafter "FCC Payphone Order"); *Order On Reconsideration,* In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996 / Policies and Rules Concerning Operator Service Access and Pay Telephone Compensation, FCC No. 96-439, CC Docket Nos. 96-128, 91-35, and 96-439, 11 FCC Rcd 21233; 1996 FCC Lexis 6257; 5 Comm. Reg. (P & F) 321 (November 8, 1996) (hereafter, "FCC Payphone Order on Reconsideration"). In the *FCC Payphone Order*, that agency determined that the existing new services test should be applied to ILEC payphone operations to insure that Section 276(a) was satisfied. FCC Payphone Order, ¶146; FCC Payphone Order on Reconsideration, ¶163, and n. 492. The New Services Test is codified as 47 C.F.R. 61.49(g). FCC Payphone Order on Reconsideration, ¶163, n. 492. Staff IB at 54-55.

Staff explained that the New Services Test is essentially a mechanism that imposes a cost-based price ceiling on certain ILEC services. This Commission has determined that, to comply with Section 276(a), SBC's rates for services provided to IPPs must satisfy both the New Services test, and imputation requirements. Payphone Order at 11, 20. In its *Payphone Order*, the Commission found that, when an ILEC's payphone rates pass the imputation test established in Code Part 792, it satisfies the anti-subsidy requirements of Section 276. Payphone Order at 6, 11. Likewise, the Commission determined that, since the purpose of the New Services Test is to establish a price ceiling on the services that an ILEC charges to IPPs, an ILEC complies with the anti-discrimination provisions of Section 276 when its payphone rates satisfy the Cost of Service rules the Commission established in Code Part 791 (LRSIC), with an overhead allocation added. Payphone Order at 37. Applying these principles, the Commission found that SBC's then-effective rates did not satisfy the New Services Test, and directed the company to file revised tariffs. Id. at 35. The Commission determined that SBC's then-effective rates satisfied imputation. Staff IB at 55.

Staff noted that the Commission's decision to permit SBC to raise its UNE loop rates, which, obviously, the Commission made subsequent to entry of its *Payphone Order*, has the effect of causing the COPTS rates SBC charges independent payphone

providers for network access to fail imputation in all but one access area. Staff Ex. 1.0, Schedule 1.03; Joint CLEC Ex. 1.0 at 31-32; SBC Ex. 1.0 at 33. However, it is also the case that these COPTS rates are set – at least in broad outline – under federal guidelines. The question is, then, to what, if any, extent imputation requirements conflict with these federal guidelines. Staff IB at 56.

B. Preemption

1. Direct Testimony

Mr. Koch did not address this issue in his direct testimony. See Staff Ex. 1.0.

2. Rebuttal Testimony

Mr. Koch did not address this issue in his rebuttal testimony. See Staff Ex. 2.0.

3. Legal Argument in Briefs

Staff opined that, facially, at least, the question of preemption is in this case fairly clear. Section 276(c) of the federal Act provides, as noted above, that: "To the extent that any State requirements are inconsistent with the Commission's regulations [promulgated under Section 276, and including 47 C.F.R. §61.49(g)], the Commission's regulations on such matters shall preempt such State requirements[.]" 47 U.S.C. §276(c). However, a closer analysis reveals that this is of little utility in resolving the preemption question. Staff IB at 56.

Staff reasoned that as Section 276 requires that ILEC payphone rates be set in such a manner as to be non-discriminatory, and to not subsidize the ILEC's own payphone operations; however, the Congress left to the FCC the specifics of how to implement these requirements, authorizing the FCC to make rules that establish non-structural safeguards to assure compliance with Section 276(a). 47 U.S.C. §276(b)(1)(C). The FCC accomplished this by applying the New Services Test, 47 C.F.R. §61.49(g), to ILEC payphone operations. Staff IB at 56.

Staff noted, however, that Section 61.49(g) does not, in and of itself, contain substantive requirements regarding how to implement the New Services Test. This regulation, then, is obviously a requirement that filings take a certain prescribed form, a conclusion confirmed by the title of Section 61.49 – "Supporting information to be submitted with letters of transmittal for tariffs of carriers subject to price cap regulation." 47 C.F.R. §61.49. It is clear that the FCC required such filings so that the agency reviewing the filing (in this case, a state Commission) has information sufficient to determine whether the rates in question are cost based, consistent with the requirements of Section 276 with regard to the removal of subsidies from exchange and

exchange access services, and nondiscriminatory. Clearly, Section 61.49(g) does not impose *substantive* requirements. Staff IB at 57-58.

Some additional guidance is to be found in the FCC's *Payphone Order on Reconsideration*. There, the FCC ruled that:

> We require LECs to file tariffs for the basic payphone services and unbundled functionalities in the intrastate and interstate jurisdictions as discussed below. **LECs must file intrastate tariffs for these payphone services and any unbundled features they provide to their own payphone services. The tariffs for these LEC payphone services must be: (1) cost based; (2) consistent with the requirements of Section 276 with regard, for example, to the removal of subsidies from exchange and exchange access services; and (3) nondiscriminatory. States must apply these requirements and the Computer III guidelines for tariffing such intrastate services.** States unable to review these tariffs may require the LECs operating in their state to file these tariffs with the Commission. In addition, LECs must file with the Commission tariffs for unbundled features consistent with the requirements established in the Report and Order. LECs are not required to file tariffs for the basic payphone line for smart and dumb payphones with the Commission. **We will rely on the states to ensure that the basic payphone line is tariffed by the LECs in accordance with the requirements of Section 276.** As required in the *Report and Order*, and affirmed herein, all required tariffs, both intrastate and interstate, must be filed no later than January 15, 1997 and must be effective no later that April 15, 1997. Where LECs have already filed intrastate tariffs for these services, states may, after considering the requirements of this order, the *Report and Order*, and Section 276, conclude: 1) that existing tariffs are consistent with the requirements of the *Report and Order* as revised herein; and 2) that in such case no further filings are required. We delegate authority to the Common Carrier Bureau to determine the least burdensome method for small carriers to comply with the requirements for the filing of tariffs with the Commission, such as those suggested by NTCA.

FCC Payphone Order on Reconsideration, ¶163 (emphasis added; notes omitted).

While the FCC has subsequently given state Commissions some additional guidance regarding how to implement ILEC tariffs that satisfy the New Services Test (see FCC Payphone Order on Reconsideration, ¶163), this guidance has been modest, as can be seen from the FCC's adoption of its *Order*, In the Matter of Wisconsin Public Service Commission: Order Directing Filings, FCC No. 02-25; CPD 00-01 (January 31,

2002) (hereafter "WPSC Order"). In that *Order*, the FCC determined that : "States may continue to use UNE loading factors to evaluate BOCs' overhead allocation for payphone services, but we do not require that UNE overhead allocations must serve as a ceiling on payphone service overhead loading." WPSC Order, ¶58. Staff IB at 59.

In sum, the Staff noted that the FCC has determined that state Commissions are to oversee implementation of Section 276(a). *See* FCC Payphone Order on Reconsideration, ¶163 (ILECs are to file intrastate tariffs, to be reviewed by state Commissions). The FCC requires states to use, as one vehicle for accomplishing this end, the New Services Test, which is, as seen, a price cap requirement, with which ILECs must demonstrate compliance through filings that include certain information in a prescribed form. States, in turn, must evaluate ILEC payphone tariffs thus filed to make certain that COPTS rates are cost based, consistent with the requirements of Section 276 with regard to the removal of subsidies from exchange and exchange access services, and nondiscriminatory. To the extent a state regulation does not impede these requirements, it is difficult to see how such a regulation would be preempted. Staff IB at 59.

Staff noted that while it would appear at first blush that the Illinois requirement that SBC's payphone rates pass imputation conflicts with Section 276 to the extent that it requires an increase in such rates above federally-mandated levels, this is simply not the case. In its *Payphone Order*, this Commission did not so much *set* payphone rates as *establish a methodology* by which such rates properly are set. *See* Payphone Order at 37 (Commission establishes methodology to yield reasonable, Section 276-compliant payphone rates). Staff IB at 60.

Staff emphasized that this is an important point. The FCC has required ILECs to tariff, and the state Commissions to implement, among other things, "cost based" rates. Payphone Order on Reconsideration, ¶163. It stands to reason that an ILEC's cost structure can, from time to time, change. Indeed, the Commission determined, in its *SBC UNE Loop Order*, that SBC's TELRIC costs associated with providing the loop on an unbundled basis has increased over time. *See, generally, Order*, Illinois Bell Telephone Company: Filing to increase Unbundled Loop and Nonrecurring Rates, ICC Docket No. 02-0864, 2002 Ill. PUC Lexis 564 (June 9, 2004). Thus, it stands to reason that, as SBC's costs associated with COPTS access increase, of which the loop comprises a substantial portion, COPTs rates ought to increase as well. In short, the Commission need not and should not assume that the rates established as a result of its *Payphone Order* are set in stone. If – as is the case – SBC's COPTS rates do not satisfy imputation, then they should increase, or should be redesigned, notwithstanding the recency of the *Payphone Order*. Staff IB at 60.

Consequently, Staff concluded that it becomes clear that there is no preemption question here. The Commission can devise a solution in which SBC's COPTS rates satisfy *both* Section 276 requirements *and* imputation. Id.

Staff noted that the IPTA appears to suggest that Section 276 preempts further Commission action regarding payphone rates. IPTA Ex. 1.0 at 8-9. As noted above, however, what Section 276 preempts is any state law, regulation or rule that mandates payphone rates which (1) are discriminatory; (2) are not cost-based; or (3) subsidize the ILEC's own payphone service. A reevaluation of payphone rates, based on new cost information, and conducted according to the methodology established by the Commission in its *Payphone Order*, would very clearly *not* constitute such a law, regulation, or rule. Indeed, to the extent that SBC's COPTs rates no longer pass imputation, such rates are arguably not cost-based as required by Section 276. Staff IB at 60-61.

Staff found that the IPTA makes much of the fact that the Commission issued its *Payphone Order* over six years after the IPTA filed its Petition. IPTA Ex. 1.0 at 5, 6. This, it suggests, has worked a major hardship on IPPs, as they were compelled during that period to pay "excessive payphone access rates that were not in compliance with the Federal requirements[.]" Id. at 5. The IPTA suggests that the fact that it and its members "were compelled to pour significant resources into [the ICC] investigation" leading to COPTS rates somehow prevents the Commission from reviewing the rates in question in the light of new information. Staff IB at 61.

However, as the Commission noted in the *Payphone Order*, the alleged delay in resolution of the proceeding was attributable in large part to IPTA's desultory pursuit of its claim; by way of example, IPTA filed its Direct Testimony in the *Payphone Proceeding* nearly six months late. Payphone Order at 43, n.16. Staff IB at 61.

Accordingly, Staff pointed out that the IPTA's claim that it is somehow hard done by should fall on deaf ears. The IPTA's members paid lawful, tariffed rates at all relevant times, and indeed those rates were, as the Commission noted, characterized by "deep discounts". Moreover, even if this were not the case, the IPTA cannot be heard to argue that the Commission has no authority to revisit its past rate decisions. *See* 220 ILCS 5/10-113 (Commission may alter or amend decisions). Staff IB at 62.

In summary, Staff noted that IPTA seeks to maintain rates for its members at a level far more advantageous than those available to any other retail business customer. There is no public policy basis for such treatment, and, as noted above, it would violate state law. The IPTA's arguments should therefore be discounted. Staff IB at 62.

The Staff explained that it does not suggest that the Commission erred in its *Payphone Order*. To the contrary, the Commission adopted a correct methodology for

payphone services imputation, application of the New Services Test, and application of the proper overhead loading factor. Moreover, based upon the cost information available in that proceeding, the Commission ordered implementation of the proper rates. Further, the Commission established a methodology that can be utilized to reset COPTS rates at such time as a change in circumstances warrants it. Specifically, these rates are to be calculated using the LRSIC for the service as well as an allocation of common overheads based on UNE overhead factors. Staff IB at 62.

Finally, the Staff pointed out that there has been a change in circumstances since the entry of the *Payphone Order*. Specifically, the Commission has approved a change in SBC's methodology for determining UNE loop rates, which includes UNE loop costs for COPTS lines. *See, generally,* SBC UNE Loop Order. Although the change in methodology is for UNE loop rate calculations, it is significant in that the methodology also affects the retail COPTS rate calculations. Namely, the Commission approved a change in the cost model by which SBC calculates its UNE loop costs. The new model, LoopCAT, is not yet currently being used by SBC to calculate the LRSIC for retail COPTS lines, but the company concedes that it should do so on a going forward basis. In as much as the LRSIC for COPTS services needs to be updated to reflect the adoption of the new cost model, the retail rate for COPTS will be affected. Second, SBC's UNE overhead factor was modified as a result of the Order. As was indicated above, the UNE overhead factor is a component of the COPTS rate calculation methodology for SBC's payphone rates. Accordingly, the Commission can, if it sees fit to do so, quite properly reset SBC's COPTS rates, such that they satisfy the imputation requirement. Staff IB at 63.

C. Rate Options If Preemption Does Not Apply

1. Direct Testimony

Mr. Koch did not address this issue in his direct testimony. See Staff Ex. 1.0.

2. Rebuttal Testimony

Mr. Koch did not address this issue in his rebuttal testimony. See Staff Ex. 2.0.

3. Legal Argument in Briefs

Staff pointed out that one solution that the Commission might consider is to order SBC to modify its retail COPTS rates. This appears to be a feasible approach. The Commission has, in the *Payphone Order*, set forth a methodology to set – and, accordingly, to reset – COPTS rates. As shown above, factors affecting this methodology have changed as a result of the SBC UNE Loop Order. Under this

approach, SBC would file revised tariffs supported by an up-to-date LRSIC study, and using an up-to-date shared and common cost loading. SBC IB at 63-64.

VII. Conclusion

Staff is convinced that SBC's retail business NAL is subject to imputation; that the UNE loop is a noncompetitive service or service element used to provide a competitive service within the meaning of Section 13-505.1 of the Public Utilities Act, such that SBC's retail business NAL must satisfy imputation based upon the TELRIC rate it charges for the UNE loop. Staff is further convinced that a "narrow" imputation test is the only lawful and proper test to use, and that revenues from usage and vertical services cannot and should not be included. Staff contends that SBC's retail business NAL rates do not pass imputation under a properly constructed test. Staff notes that there a number of rate design options that SBC can use to deal with this problem, but the Commission is under no obligation to give SBC direction or guidance in this regard. Finally, the Staff argues that Section 276 does not preempt the application of the imputation test to COPTS rates, and those rates can be altered consistent with both Section 276 and imputation, based on the methodology established by the Commission in its *Payphone Order*.